Get Real! Individuals Prefer More Sustainable Investments.

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levelEEI

Level the playing field for Energy Efficiency Investment products

EUROPEAN
COMMISSION

Brussels, 21.4.2021
COM(2021) 188 final

COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS

EU Taxonomy, Corporate Sustainability Reporting, Sustainability Preferences and Fiduciary Duties:
Directing finance towards the European Green Deal

VI. SUSTAINABILITY PREFERENCES AND FIDUCIARY DUTIES

The Commission is today introducing the assessment of client's sustainability preferences in existing delegated acts under the Markets in Financial Instruments Directive (MiFID II)[17] and the Insurance Distribution Directive (IDD)[18], as a top up to the suitability assessment. Insurance and investment advisers will be required to obtain information not only about the client's investment knowledge and experience, ability to bear losses, and risk tolerance as part of the suitability assessment, but also about their sustainability preferences. This will ensure that sustainability considerations are taken into account on a systematic basis when the advisers assess the range of financial instruments and products in their recommendations to clients.

This action will empower retail investors to decide where and how their savings should be invested. This way, everyone will have a chance to make a tangible positive impact on the climate, environment and society if they desire to do so. The change will increase the demand for financial instruments and products with sustainable investment strategies and those that consider adverse impact on sustainability.

By amending existing rules on fiduciary duties in delegated acts for asset management, insurance, reinsurance and investment sectors, the Commission is clarifying the current rules to also encompass sustainability risks such as the impact of climate change and environmental degradation on the value of investments.

What Do Private Investors Want?

The Journal of FINANCE
The Journal of THE AMERICAN FINANCE ASSOCIATION

THE JOURNAL OF FINANCE • VOL. LXXII, NO. 6 • DECEMBER 2017

Why Do Investors Hold Socially Responsible Mutual Funds?

ARNO RIEDL and PAUL SMEETS*

ABSTRACT

To understand why investors hold socially responsible mutual funds, we link administrative data to survey responses and behavior in incentivized experiments. We find that both social preferences and social signaling explain socially responsible investment (SRI) decisions. Financial motives play less of a role. Socially responsible investors in our sample expect to earn lower returns on SRI funds than on conventional funds and pay higher management fees. This suggests that investors are willing to forgo financial performance in order to invest in accordance with their social preferences.

What Do Private Investors Want?

The Arbitrageur

The Talker

The Giver

What Do Private Investors Want?

Social identification and investment decisions

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A B S T R A C T

This paper investigates the role of social identification in investment decisions. Social identity is an aspect of self-image based on in-group preferences and a perception of belonging to a social group. We collected survey data from retail clients of the only two banks in the Netherlands that exclusively offer socially responsible investment products and savings accounts. Our data show that almost half of the clients invest exclusively at these banks, whereas the other half also holds at least one conventional investment account. Clients vary widely in the extent to which they identify themselves with socially responsible investments (SRI). Investors with a strong social identification allocate substantially more of their wealth to these banks, both in terms of euros invested and in terms of percentage of their total portfolio invested. Social identification also mediates the effect of expected returns on SRI. Our results further show that social identification is stronger among highly educated, younger and low-wealth investors.

Last Monday…

EUROPEAN COMMISSION

Strasbourg, 6.7.2021
COM(2021) 390 final

COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS

Strategy for Financing the Transition to a Sustainable Economy

{SWD(2021) 180 final}

EN EN

Aligning financial flows with the European Green Deal objectives requires further consideration of sustainability impacts in the strategies and investment decision-making processes of investors. On 21 April 2021, the Commission published six amending delegated acts, which require financial firms, such as advisers, asset managers and insurers, to include financially material sustainability risks in their procedures and to consider the sustainability preferences of their clients[50]. This will need to be complemented by further action for the 125 000 pension funds in the EU managing collective schemes on behalf of around 75 million Europeans[51]. To enhance their contribution to the Green Deal targets, it is critical that the fiduciary duties of investors and pension funds towards members and beneficiaries also reflect the inside-out ESG risks of investments as part of investment decision-making processes.

- The Commission will ask EIOPA to assess the potential need to broaden the concept of the 'long-term best interest of members and beneficiaries' and introduce the obligation to consider sustainability impacts in the pension investment framework. The aim would be to ensure that the framework better reflects members and beneficiaries' sustainability preferences and broader societal and environmental goals. In collaboration with the European Supervisory Authorities, the Commission will consider and assess further measures to enable all relevant financial market participants and advisers to consider positive and negative sustainability impacts of their investment decisions, and of the products they advise on a systematic basis.

Meanwhile in the Netherlands

Case Study Pension Fund Detailhandel

- Pension fund for the retail sector in the Netherlands: defined benefit plan, 35 billion US$ AUM, more than a million beneficiaries, run by a small team of delegation experts.

- Investment program guided by realism: focus on high-quality governance of the strategic investment delegation process with almost exclusive focus on public and passive investments.

- In 2018, the responsible investment program can be characterized by a limited exclusion policy (controversial weapons), proxy voting based on internal voting guidelines, and private engagement through an outsourced collaborative vehicle.

- Investment belief that the "integration of sustainability can be implemented without compromising key portfolio characteristics (risk and return)".

Guided by Beneficiaries’ Preferences

- PD approached Maastricht University Sustainable Finance Centre (ECCE) to conduct a field survey in 2018 (Study 1) among their participants. Second survey conducted in 2020 (Study 2).
- Inspired by upcoming hard and soft law, the board granted its participants a real vote on PD’s sustainable-investment policy. Key question was whether the engagement program should be intensified (more engagements) and extended with a fourth, additional SDG.
- Close to 70% of participants (10% against) are willing to expand and intensify the fund’s engagement with companies based on selected SDGs, even when they expect engagement to hurt the financial performance. Study shows that participants’ strong social preferences drive this result.
- Board of Trustees executed the vote within one week after the publication of research results (November 2018).
- Study 2, conducted in June 2020, shows that strong preferences remain stable and that COVID has a negligible impact.

Pensioenfonds Detailhandel

Current engagement strategy

Climate change

Reduction of CO_2

Decent work

Gender equality

Justice

No corruption

Adding one additional SDG

Responsible consumption and production

Supply Chain

Main Question

Do you want Pensioenfonds Detailhandel to add the fourth sustainable development goal ‘Responsible consumption and production’?

Yes, add

No, do not add

No opinion

Real vote

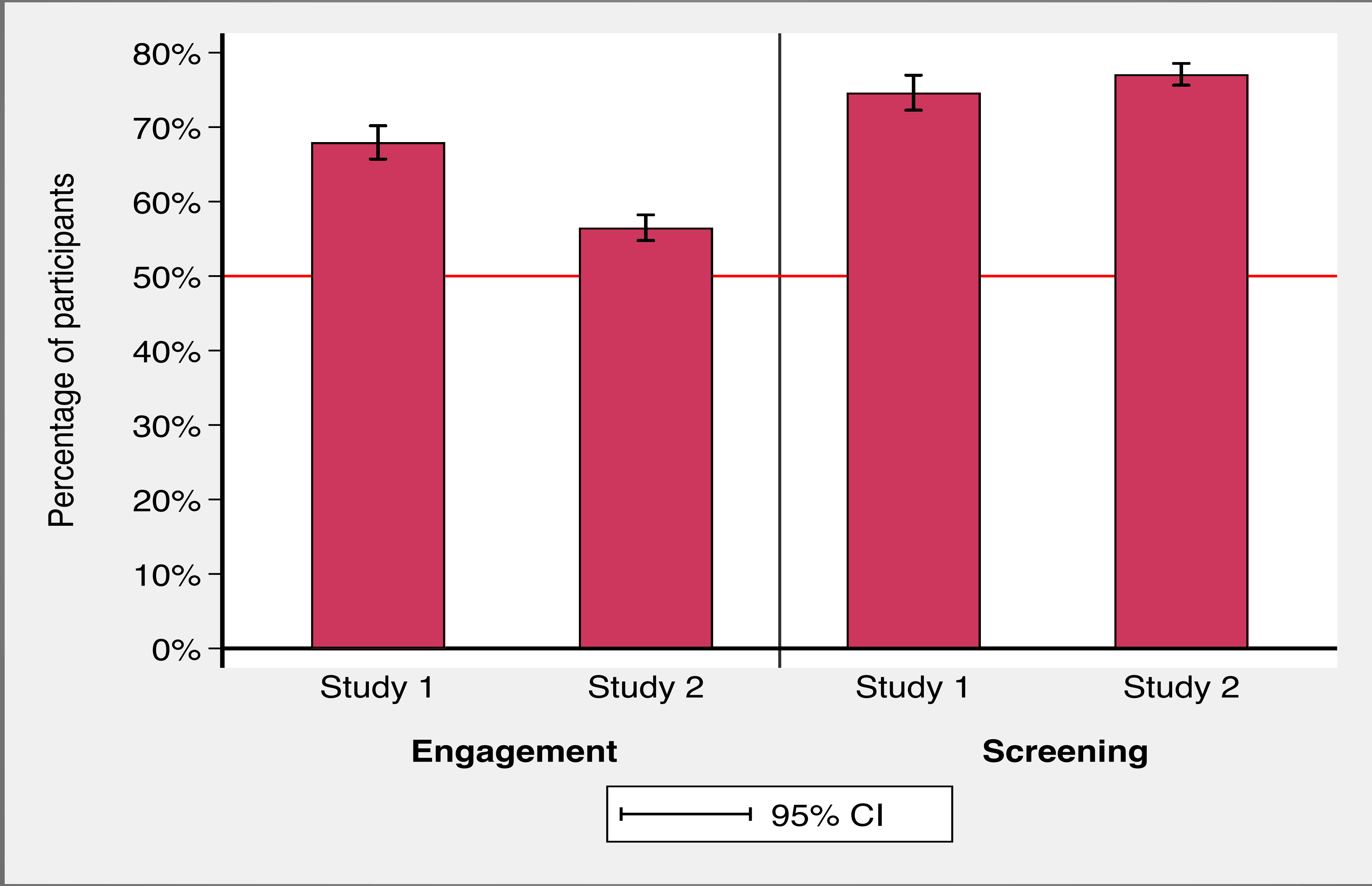
Voting

50% rule

Choice is implemented

Which percentage chooses 4 SDGs?

Engagement versus Screening, Study 1 and 2



Additionally.....

Case study

Pensioenfonds Detailhandel and FTSE Russell

FTSE Russell

February 2020 | ftserussell.com

FTSE Custom Developed ex Korea SDG Aligned Index

The FTSE Custom Developed ex Korea SDG Aligned Index ("SDG Aligned index") is a developed market equity benchmark launched in March 2019 that uses adjustments to constituent weights to create alignment with four of the 17 goals within the UN Sustainable Development Goals (SDGs) framework.

Objectives

The objective of the index design was to create a simple, transparent way to align a broad (developed) market portfolio with specific aspects of the SDGs. The approach adopted was based on a detailed mapping exercise of FTSE Russell's sustainable investment research and the SDG framework.

The SDG Aligned Index was developed in collaboration with a PRI signatory, and one of the Netherlands largest pension funds, Pensioenfonds Detailhandel ("Detailhandel") and now forms the basis of a €5.8bn mandate (as of March 29, 2019).

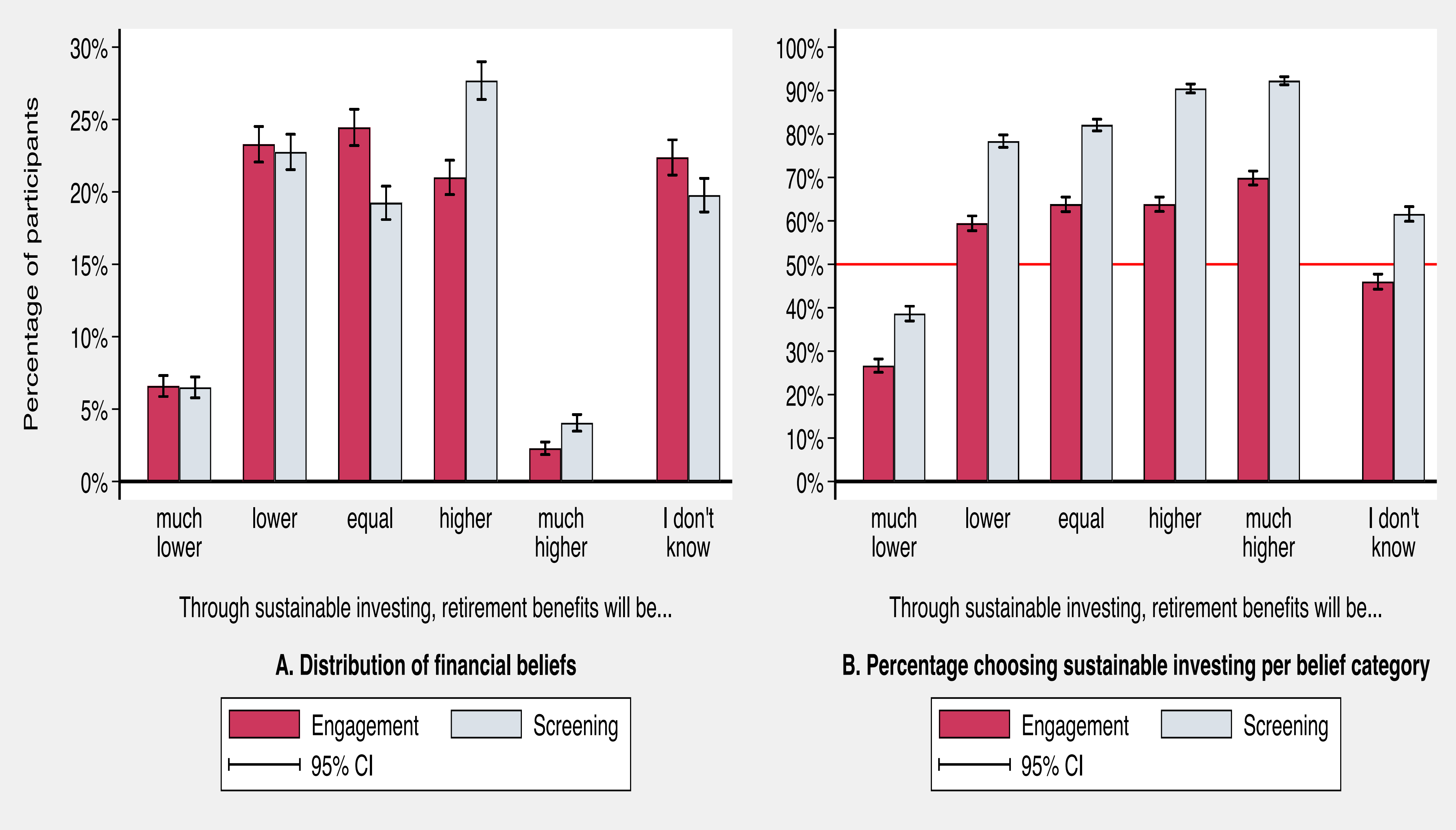
The index was developed to support the implementation of Detailhandel's sustainable investment (SI) policy, which identifies areas of overlap between its SI objectives and the SDGs. Specifically, Detailhandel identified the following SDGs as relevant to its SI policy:

1. **SDG 8** – Decent work and economic growth
2. **SDG 12** – Responsible consumption and production
3. **SDG 13** – Climate action
4. **SDG 16** – Peace, justice and strong institutions

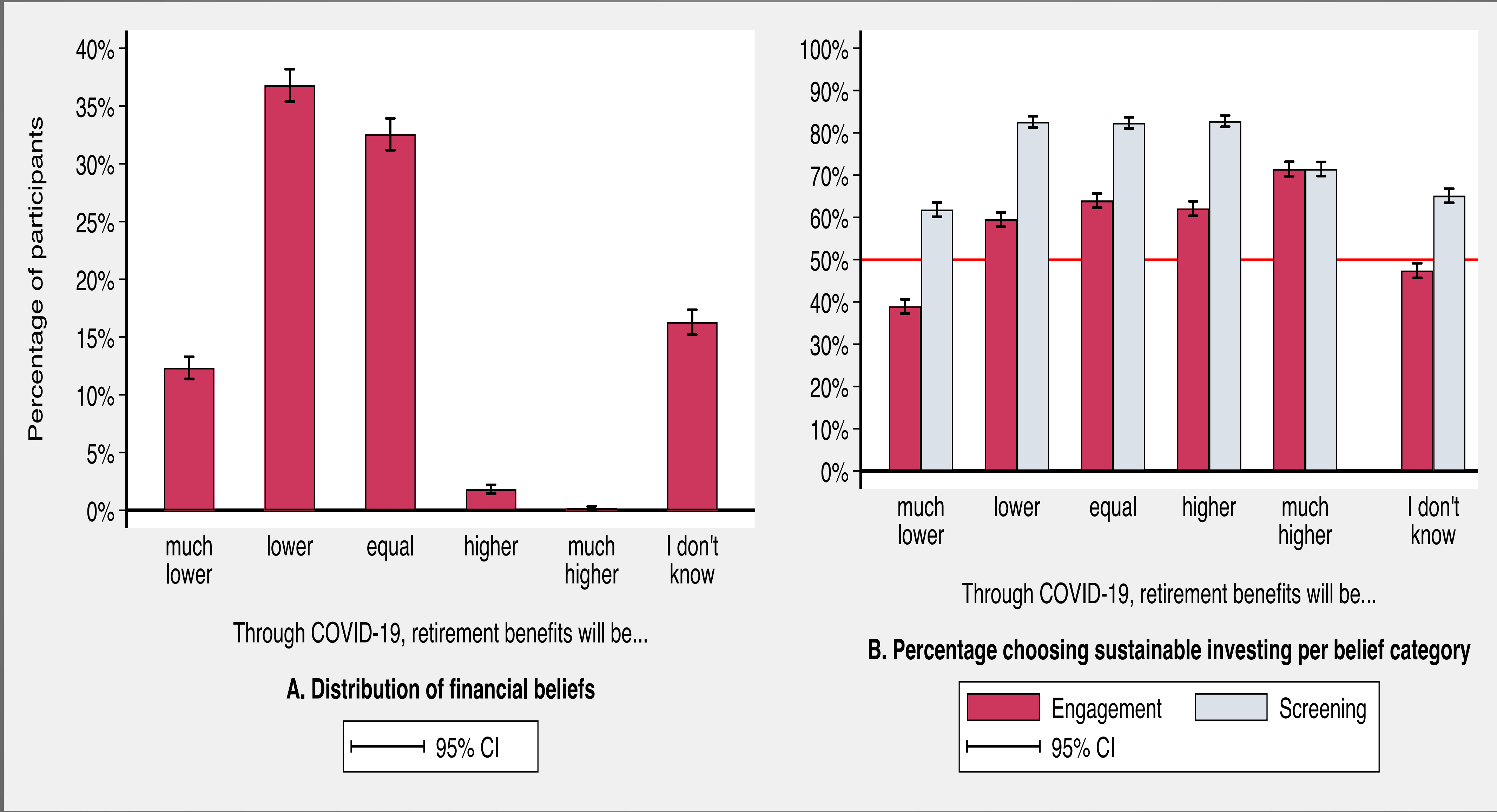
For Detailhandel in particular, the index is an important first step in helping align their entire investment strategy with their environmental, social and governance

- Detailhandel and FTSE created a customized SDG index based on preferences of beneficiaries.
- Board of Trustees executed the vote within one week after the publication of research results (November 2018).
- Study 2, conducted in June 2020, shows that strong preferences remain stable, that beneficiaries like the customized index, and that COVID has a negligible impact on preferences.

Beliefs versus Preferences, Study 2



Impact of COVID-19, Study 2



Get Real! Individuals Prefer Sustainable Investments

The Review of Financial Studies

SFS

Get Real! Individuals Prefer More Sustainable Investments

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The United Nations' Sustainable Development Goals (SDGs) have created societal and political pressure for pension funds to address sustainable investing. We run two field surveys (n = 1,669, n = 3,186) with a pension fund that grants its members a real vote on its sustainable-investment policy. Two-thirds of participants are willing to expand the fund's engagement with companies based on selected SDGs, even when they expect engagement to hurt financial performance. Support remains strong after the fund implements the choice. A key reason is participants' strong social preferences. (*JEL* G02, G11, G20, G23, G28)

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Preferences are relevant..!

- Social preferences have a significant influence on many economic decisions including investments and individual retirement provisions, as they are key to understanding what incentivizes people.

- Irrespective of a fund's legal context, knowledge of participants' preferences and beliefs about sustainable investments is valuable.

- Research shows that consumers of financial services who stronger identify with their service providers are more loyal customers.

- Particularly in a time when trust in the financial sector plummeted after the GFC and beyond, better understanding of beneficiaries' preferences and beliefs will help bring back confidence to the sector.

- Trustworthiness is a financial institution's most valuable asset…….

Many questions remain

- Are there any different approaches to measure these preferences properly? For instance, focus groups, interviews etc.
- How to deal with (potentially) low response rates, potential selection biases and sustainability illiteracy.
- How to turn measurement of preferences into (scalable) portfolio solutions?
- Do clients care about real societal impact or is it just connected to having a "warm glow"?
- Most importantly: how to prevent that financial service providers misuse the survey instrument (or any other elicitation method) to lure private individuals into high-cost sustainability vehicles…?

Questions?